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July 15, 1996

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Federal Communications Commission
Office of Secretary

Mr. William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street
Washington, D.C. 20554

Re: Implementation of the Local Competition Provisions in the Telecommunications Act of 1996
CC Docket No. 96-98
Notice of Oral and Written Ex Parte Presentations

Dear Mr. Caton:

On this date Alexander Netchvolodoff and Alexandra Wilson of Cox Enterprises, Inc. ("Cox") met with Daniel Gonzales of Commissioner Cong's office. During that meeting, they discussed matters relating to Cox's comments in the above-referenced proceeding. In addition, Mr. Gonzales is being provided with a copy of the attached materials concerning the effects of setting the compensation for transport and termination at different levels.

In accordance with the requirements Section 1.1206(a) of the Commission's Rules, an original and one copy of this letter are being submitted to the Secretary's office and copies of this letter are being provided to the Commission staff participants in the meeting.

Please inform me if any questions should arise in connection with this letter.

Respectfully submitted,

J.G. Harrington

JGH/taf

cc: Daniel Gonzales, Esq.

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1/2 OR 2/10 OF A CENT: DOES IT MATTER?

One question that has arisen in discussions of appropriate interconnection rates is whether, if the reciprocal compensation for transport and termination is relatively low, the specific amount per minute is important. This paper briefly describes several reasons why the Commission should choose a compensation rate at the lower end of the range of possible rates.

- **Higher rates create uneconomic incentives:** If interconnection compensation is reciprocal, higher interconnection rates create significant incentives for all interconnectors to seek customers who terminate more calls than they receive, because those customers generate a revenue stream from termination fees. These incentives increase as interconnection rates go up and are accentuated if interconnection rates exceed cost. This could lead to irrational results, such as a telephone competitor that serves only Internet service providers. It also could increase pressure for LECs (both incumbents and new entrants) to eliminate flat-rated pricing in favor of rate plans that charge customers based on the number and duration of the outbound calls they make.

- **High rates harm new entrants more than low rates could hurt incumbents:** Interconnection compensation is unlikely to be an important part of LEC cost recovery, especially because, on average, traffic will balance. That is not true of new entrants. High interconnection rates would constitute a significant proportion of a new entrant's costs. Moreover, new entrants might have temporary traffic imbalances, especially during their start-up phases. High interconnection charges will make it difficult for new entrants with temporary net outflows of traffic to succeed in the short term. In any event, incumbents should be required to impute their interconnection costs in determinations of whether their rates recover the costs of providing service. Otherwise, incumbents have every incentive to inflate their costs and no incentive to report actual costs.

- **There is little likelihood of bargaining away from excessive transport and termination charges to cost or bill & keep arrangements:** The 1996 Act is based on a negotiation model, but in practice new entrants have relatively little bargaining power. Incumbent LECs will have no incentive to bargain down from a high interconnection rate to a rate that reflects actual cost. On the other hand, if the interconnection charge is relatively low, new entrants may be able to bargain up from that level in return for concessions from the incumbent. Thus, a high interconnection charge reinforces the incumbents' existing bargaining power, while a low charge enhances the new entrants' bargaining ability.

- **It is inefficient to permit charges that exceed costs for an intermediate good:** Transport and termination is an intermediate good. By itself, transport and termination has no value; it only has value as an element in the provision of local telephone service. If compensation for transport and termination is set at cost, then it will be possible to price a new entrant's telephone service at economically efficient levels, to the benefit of consumers. If, however, compensation is set above cost, then the new entrant will be forced to set rates that are above the true cost of service if it wants to recover its actual costs of termination and transport. This will reduce consumer welfare and transfer wealth to the incumbent.

- **High rates are not justified by the evidence:** There is no evidence before the Commission that justifies rates as high as 0.5 cents per minute. The only record evidence supports rates that are much closer to 0.2 cents per minute. In other words, a rate of 0.5 cents per minute would be two and a half times the rate justified by available cost data. Even IXC access charges do not exceed cost by such a wide margin.